

AGENDA ITEM VII-C

Consideration of adopting the repeal of Sections 25.1 through 25.3 and adopting new Sections 25.1 through 25.6 of Board rules, concerning the Optional Retirement Program (Second Consideration)

RECOMMENDATION:

1. Adopt the repeal of Sections 25.1 through 25.3 of Board rules concerning the Optional Retirement Program
2. Adopt new Sections 25.1 through 25.6 of Board rules concerning the Optional Retirement Program with changes

Summary:

1. The Optional Retirement Program (ORP) is an alternative to the Teacher Retirement System (TRS) for full-time faculty members and eligible administrators and professionals at Texas public institutions of higher education. The Board is charged with certain oversight responsibilities regarding operation of ORP by the institutions, as provided in Texas Government Code, Chapter 830, §830.002(c) (promotion of uniformity) and §830.101(b) (eligibility to participate).
2. HB 264, 78th Legislature, Regular Session, amended the ORP statute to provide institutions with the authority to supplement the state rate for employer contributions. HB 3459, 78th Legislature, Regular Session, established a 90-day waiting period for active membership in TRS which will delay an ORP-eligible employee's opportunity to elect ORP in lieu of TRS. These legislative changes require amendments to Chapter 25 of the Board's rules. Additionally, staff recommended that the Board adopt rules concerning uniformity in institutional administration of ORP. These amendments required the addition of several sections and a re-organization of the existing rules. For that reason, at its October 2003 meeting, the Board proposed the repeal of Chapter 25, in its entirety, and proposed the adoption of all new sections.
3. The proposed new sections represent a comprehensive overhaul of the existing rules, and staff received valuable feedback from several institutions concerning the language and terms used throughout the proposed new sections. Because numerous modifications were needed to improve clarity and consistency in the text, at its January 2004 meeting, the Board withdrew the proposed new sections that were proposed at the October 2003 meeting and proposed new sections that included the recommended

changes. To allow for existing rules to remain in place until the amendments become effective, the Board withdrew the repeal that was proposed at its October 2003 meeting and re-proposed the repeal at its January 2004 meeting. Staff recommends that the Board now adopt the repeal and proposed new sections, with several non-substantive changes based on additional comments received, as indicated below in the Comments section.

4. The recommended new rules differ from the existing rules in a number of ways:
  - (a) Recommended new Section 25.3 would add a definitions section for terms used in the rules.
  - (b) Recommended new Section 25.4 would re-organize and update the existing section 25.2 on ORP eligibility standards to:
    - (1) incorporate the changes made by HB 3459, 78th Legislature, Regular Session, regarding a 90-day waiting period for active membership in the Teacher Retirement System (TRS) which will delay an ORP-eligible employee's opportunity to elect ORP in lieu of TRS;
    - (2) update the existing ORP eligibility rules for improved clarity and consistency; and
    - (3) incorporate recent ORP eligibility policy interpretations provided by Board staff regarding dual employment in positions at different institutions, eligibility for counselors, institutional reviews of ORP-eligible positions, and procedures for handling administrative errors involving eligibility determination.
  - (c) Recommended Section 25.5 would re-organize and update the existing section 25.3 on ORP vesting and participation standards for improved clarity and consistency and to incorporate recent ORP vesting and participation policy interpretations provided by Board staff regarding employment in a non-benefits-eligible position and dual employment in positions at different institutions.
  - (d) Recommended Section 25.6 would provide a new section on uniformity of institutional administration of ORP. This section would address:
    - (1) distribution restrictions, including a prohibition on loans and procedures that an institution may use if a company provides an unauthorized distribution;
    - (2) a requirement that contributions shall be made on a tax-deferred basis;

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- (3) a requirement that ORP contracts shall include a provision that the ORP company is responsible for qualifying domestic relations orders and paying benefits in accordance with Texas Government Code, Chapter 804;
- (4) procedures for reimbursing to the originating fund any employer contributions that an ORP participant forfeited by terminating prior to vesting;
- (5) a minimum number of ORP companies that institutions shall authorize;
- (6) a minimum number of opportunities that institutions shall provide for participants to change ORP companies;
- (7) a requirement that all institutions shall establish certain policies regarding solicitation of ORP-eligible employees by representatives of authorized ORP companies;
- (8) a requirement that companies shall provide certain information to ORP participants concerning their account balances and transactions on at least an annual basis;
- (9) a requirement that companies shall submit confirmation of receipt of funds directly to each participant on at least a quarterly basis;
- (10) a requirement that companies shall submit confirmation of transfers directly to the participant immediately upon execution;
- (11) a requirement that institutions shall send all ORP contributions to the companies by electronic funds transfer and within three days of legal availability;
- (12) a requirement that institutions shall submit annual reports to the Board regarding ORP participation and any other information required by the Board to fulfill its duties under the ORP statute;
- (13) a requirement that institutions shall provide newly ORP-eligible employees with basic information on TRS and ORP (provided by the Board) on or before their first eligibility date; and
- (14) a requirement that institutions shall provide written notification to all newly ORP-eligible employees of a participant's ORP responsibilities and that the institution has no fiduciary responsibility for the market value of a participant's investments or for the financial stability of the vendors chosen by a participant.

The new recommended section would also incorporate procedures concerning:

- (1) handling IRS limits on contributions;
- (2) a prohibition on co-mingling of ORP funds with any other funds;
- (3) a prohibition on contributions to two retirement programs within the same calendar month;
- (4) the definition of eligible compensation;
- (5) procedures for providing supplemental ORP employer contributions authorized by amendments to the ORP statute by HB 264, 78th Legislature, Regular Session;
- (6) a requirement that institutions shall fund ORP employer contributions proportionately to salary source;
- (7) a requirement that an institution's list of authorized ORP companies and products shall provide a reasonable variety of choices among types of accounts and funds, including at least one company that offers 403(b)(1) annuity accounts and at least one company that offers 403(b)(7) custodial accounts;
- (8) a requirement that an institution shall not authorize a company to receive contributions from unvested participants unless the company has certified to the institution that the entire amount of actual unvested employer contributions will be returned to the institution if the participant terminates prior to vesting;
- (9) a requirement that institutions shall start sending a participant's contributions to the participant's newly selected company no later than 35 days after the date the participant signs and submits the appropriate forms to the institution;
- (10) a provision that all of an active participant's ORP contributions, even those sent to previously selected companies and those made during prior periods of employment, are covered by the distribution restrictions until the participant terminates employment from all institutions;
- (11) a provision that institutions may allow participants to continue contributing to a company even after it is no longer on the institution's authorized list ("grandfathered" company) and may allow participants who directly transfer from another institution to continue contributing to the same company that they were contributing to at the other institution, provided

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the institution verifies that the contract includes the distribution restrictions;

- (12) provisions regarding authorization of company representatives;
- (13) provisions regarding investment advisory fees;
- (14) a notification requirement for institutions to inform terminating participants of the institution's procedures for handling certification of a participant's eligibility for retiree group insurance; and
- (15) a requirement that institutions shall establish procedures that will document when participants have received the notices required by this section.

Date Presented to the Board for Publication in the Texas Register: January 29, 2004

Date Published in the Texas Register: February 20, 2004

Summary of comments received:

- 1. No comments were received regarding the proposed repeal.
- 2. The following comments were received regarding the proposed new sections:

Comment 1: Texas Tech University staff recommended adding "insurance" between "applicable" and "eligibility requirements" in the definition of ORP retiree in Section 25.3(13) to clarify that the requirements are not ORP requirements.

Response: Staff agrees with the comment and "retiree insurance" has been added to the definition to promote further clarity.

Comment 2: The Texas Association of Insurance and Financial Advisors (TAIFA) commented on Sections 25.6(a)(3)(C) and 25.6(c)(7)(A) and (B), relating to a requirement that ORP contributions may only be made to an ORP contract that is authorized by the participant's current employing institution, including companies that the institution has "grandfathered" or otherwise authorized on an individual basis after confirming that the contract is a valid ORP contract. TAIFA expressed concern that ORP participants should be able to contribute to any Texas ORP account, including accounts from prior employment with a different institution, provided the statutory distribution restrictions are in place, because preventing a participant from contributing to an existing account could take away the advantage of break points available in mutual funds and

some of the favorable provisions in older annuity contracts such as higher fixed interest rates and expired surrender charges. Security Benefit Life Insurance Companies (Security Benefit) also commented on these sections, expressing concern that employees should be allowed to transfer ORP accounts between institutions and to move funds in a grandfathered account into an active account, which would allow participants to stay abreast of the constantly changing products.

Response: Staff agrees with TAIFA that ORP contributions should only be sent to valid ORP contracts that contain the statutory distribution restrictions, and these Chapter 25 provisions require institutions to confirm that the restrictions are in place before authorizing ORP contributions to be sent to those contracts. The ORP statute provides that the institutions shall establish the ORP contracts for their employees, so it is the institutions' responsibility to ensure that ORP contributions are only sent to valid ORP contracts. However, these provisions do not require institutions to send ORP contributions to any particular company, including a company that a new employee has an account with from a prior period of employment with another institution, as recommended in the comments. This position is based on two Attorney General's Opinions – JM-691 (1987) and DM-271 (1993) – that provide that the institutions are authorized to control the selection of ORP companies that do business with their employees. These Chapter 25 provisions do allow institutions to authorize contributions to companies that are not on their established list of authorized companies if they have verified that the ORP distribution restrictions are in place. These provisions do allow the types of transfers that Security Benefit referred to, as long as the current employing institution has verified that the receiving account is a valid ORP contract.

Comment 3: TAIFA expressed concern about Section 25.6(c)(3)(A), relating to a requirement that each institution must authorize at least four ORP companies, including at least one company that offers 403(b)(1) annuity accounts and one company that offers 403(b)(7) custodial accounts. TAIFA recommended that each institution should provide 12 to 16 different choices of companies because if only four companies are allowed and four types of products are available (fixed annuity, variable annuity, no-load mutual fund and load mutual fund), a participant could only have one choice for their selected type of investment, which would be problematic for participants with large account balances who don't want to have all their funds invested with one company because of concerns about recent mutual fund investigations and company solvency. Security Benefit requested consideration for increasing the minimum number of companies authorized by the institutions, especially with respect to 403(b)(1) annuity accounts and 403(b)(7) custodial accounts, because one company providing these services may not provide adequate options to the employees, especially when the market is volatile and companies continue to experience market conduct issues.

Response: Staff agrees that diversification is an important tool for prudent investing. However, this provision, which dates back to the early years of the program, provides for a minimum, not a maximum, of four companies, so institutions are free to authorize as many qualified companies as they choose to, as provided in subparagraph (C) of that

same provision ("No Maximum Number"). Subparagraph (B) of that same provision ("Variety of Choices") also addresses this concern by requiring employers to provide a reasonable variety of choices among types of accounts and funds. Currently, all institutions provide a selection of at least eight companies, many institutions have between 10 and 20 authorized companies, and some have authorized in excess of 20 companies. Most, if not all, institutions have "grandfathering" policies that allow participants to continue sending ORP contributions to a company if it is removed from the institution's list of authorized companies (for example, because of low participation, which is a client-driven provision). The actual number of companies currently receiving ORP contributions across the state is in excess of 100. Furthermore, offering one to four companies is common among comparable ORP-type plans administered by university systems in states outside of Texas, so establishing a minimum of four companies for Texas ORP would not be inconsistent with other such plans. Staff monitors activity in this area through the annual ORP participation reports submitted by the institutions and will be able to respond if problems arise.

Comment 4: TAIFA commented on Section 25.6(c)(5)(B), which allows institutions to scrutinize the quality of ORP products and select ORP companies and products through a competitive bid process. TAIFA recommended that competitive bids should be used cautiously, with all factors considered, not just cost, because if only cost is considered, they are concerned that the option of financial advisors would be taken away. Security Benefit expressed concern about the term "competitive bid process" in this provision and recommended additional wording to clarify that the intent of this regulation is not to eliminate options or services to employees, because unless clearly stated, the competitive bidding process often focuses on product pricing and fees. The University of Texas System Office commented that selection of ORP vendors through a "competitive bid process" is problematic for the U.T. System given the request from the Legislature in the past that a minimum criteria methodology be utilized to select vendors.

Response: The language in this provision, which was taken directly from Attorney General's Opinion DM-271 (1993), includes "quality" as part of the process, so this provision was not intended to imply that cost should be the only factor or that a low-bid process is required. Staff agrees that the wording should be clarified to promote understanding of the intent, so this provision has been amended by changing the term "competitive bid process" to "competitive selection process," adding "minimum criteria process" as an option, and including examples of the types of criteria that institutions may utilize that are related to performance and services rather than specifically to cost.

Comment 5: TAIFA commented on Sections 25.6(c)(15)(B) and (C), which allow institutions to participate in the designation of authorized company representatives who contact their employees, including restricting the number of designated representatives. TAIFA is concerned that the participant, not the employer, should select the representative with whom they will be working, provided the representative is certified by the company, sufficiently trained, and knowledgeable about ORP, because the relationship with the representative is often more important than the company.

Response: The primary purpose of paragraph (15) is to help ensure that ORP participants are not provided incorrect or misleading information about ORP provisions by company representatives. Because the ORP statute provides that the institutions shall establish the contractual relationships, staff believes that the institutions should also have the authority to participate in the designation of the representatives of those companies who will be contacting their employees about ORP. This provision allows institutions and companies to jointly designate the authorized representatives for the purpose of certifying that they are sufficiently trained and knowledgeable about ORP provisions as well as essential local institutional ORP policies and procedures. Employees are free to choose from among the designated representatives.

Comment 6: TAIFA expressed concern that an area not addressed in the proposed rules is lump sum transfers between companies and recommended that participants should have complete control in selecting which companies have their accounts, provided the accounts are Texas ORP and have the proper distributions restrictions.

Response: Staff agrees that ORP participants should be able to make lump sum transfers between ORP companies, and Section 25.6(c)(6) has been amended to clarify that these transfers are allowed; however, to ensure that the funds are only being transferred to an ORP contract that contains the distribution restrictions, the employing institution must confirm that the contract is a valid ORP contract before authorizing a transfer for the same reasons as stated in the response to the earlier comment concerning Sections 25.6(a)(3)(C) and 25.6(c)(7)(A) and (B).

Comment 7: The University of Texas System Office commented that the proportionality provision in 25.6(a)(7) fails to specify that the provision does not apply to supplemental employer contributions that institutions may choose to make under the amendments to the ORP statute made by HB 264 (78th), which are covered in 25.6(a)(6)(C).

Response: Staff agrees and clarifying language has been added to that provision.

Comment 8: The Texas A&M University System Office staff expressed concern that 25.6(b) provides that employee contributions refunded by TRS to an ORP participant in conjunction with an election of ORP may be rolled over to the participant's ORP account. Passage of the federal EGTRAA legislation in 2001 allowed rollovers from TRS-type accounts to ORP-type accounts, but a question was raised concerning use of the term "rollover" for an in-service transaction.

Response: Staff agrees that additional clarification is needed. After consultation with the TRS legal department, staff has amended this provision and references to it in Sections 25.4(g)(3) and 25.6(a)(3)(A) to add the term "transfer" and to indicate that applicable IRS provisions regarding these types of transactions must be followed. Additional clarifying language has been added to provide a better description of the type of contributions that are affected by this provision (*i.e.*, employee contributions made to TRS after an ORP-eligible employee becomes eligible to elect ORP but prior to an election of ORP, which



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may occur because ORP-eligible employees may elect ORP up to 90 days after becoming eligible to elect ORP and membership in TRS is required until the election of ORP is made).

Comment 9: The University of Texas System Office requested that Section 25.6(f)(3), which concerns prohibited distributions by an ORP company (e.g., pre-termination loans that are not allowed under the ORP statute), should indicate that a prohibited distribution is not related to ORP but is actually a separate transaction between the ORP company and the employee, such as an unsecured loan that the company has made to the participant.

Response: Staff agrees that clarifying language should be added to this provision because the provision requires the company to redeposit funds into a participant's account as if no withdrawal had been made, which might appear to be a "double-dipping" situation (that is, the participant would have received the prohibited distribution, plus the company would be restoring funds to the ORP account).

Comment 10: The University of Texas System Office commented that §25.4(g)(2)(B) does not address the situation in which a new ORP-eligible employee's 91st day of employment falls after payroll is run for the period. They recommended that institutions be allowed to require that those employees must submit their paperwork before payroll is run for that month in order to have ORP for that month. Those employees who fail to submit ORP election paperwork prior to payroll cutoff would be placed in the Teacher Retirement System (TRS) for that month and ORP would begin for the following month.

Response: Subsection 25.4(g) establishes that an employee's ORP participation start date will depend on when the employee makes an election of ORP by submitting the ORP election forms. Paragraph (1) addresses employees who submit their ORP election forms on or before their initial ORP eligibility date, which is the 91st day of employment for new employees who are subject to the 90-day TRS waiting period. Paragraph (2) addresses employees who submit their ORP election forms after their initial ORP eligibility date. Subparagraph 25.4(g)(2)(B), which is cited in the comment, does not address the situation described in the comment because it addresses only the situation where an employee submits the ORP election forms after the month in which the 91st day of employment (*i.e.*, initial ORP eligibility date) falls.

The situation described in the comment is addressed by §25.4(g)(1)(B) or §25.4(g)(2)(A), depending on whether the forms are submitted by the initial ORP eligibility date, or after that date but before payroll is run for the month in which the ORP eligibility date falls. UT System's recommendation would be a change to §25.4(g)(1)(B), which provides that the participation start date for employees who submit their ORP election forms on or before their initial ORP eligibility date shall be the first of the month in which the initial ORP eligibility date falls, regardless of whether the forms are submitted before payroll is run for that month.

This provision is based on the long-standing ORP policy that an ORP-eligible employee who makes an election of ORP in lieu of TRS by signing and submitting the ORP election forms on or before the initial ORP eligibility date will become an ORP participant as of the initial ORP eligibility date and, therefore, will not be required to become a contributing member of TRS for that month. Immediate participation in ORP rather than contributing to TRS for the month in which the initial ORP eligibility date falls has two advantages for the employee. First, because vesting in ORP is based on actual participation, an employee who makes an election on or before the initial ORP eligibility date will be able to vest one month sooner. Second, state contributions that are sent to TRS while an employee is a contributing member cannot be recovered when the election of ORP is made because only employee contributions may be withdrawn upon termination of active membership – the state contribution remains in the TRS fund -- so an election of ORP on or before the initial ORP eligibility date provides the employee with the full state contribution (and supplemental employer contribution, if any) for that month.

Institutions may encourage ORP-eligible employees who wish to elect ORP to submit their election forms before payroll is run for the month in which their initial ORP eligibility date falls; however, it is not appropriate for an institution to force employees whose initial ORP eligibility date falls after that institution runs payroll to contribute to TRS for that month if they have actually submitted their paperwork on or before their initial ORP eligibility date.

Legal Review:

Approved by the Office of General Counsel:

\_\_\_\_\_ Date: \_\_\_\_\_